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UNITED NATIONS OFFICE FOR PROJECT SERVICES

Risk management, reserves and surplus income

Report of the Executive Director

SUMMARY

Pursuant to Executive Board decision 95/1 of 10 January 1995, the UNOPS operational reserve was initially established, following the UNDP model, at a level equal to 20 per cent of the annual administrative budget of UNOPS, rounded to the nearest hundred thousand dollars. Accordingly, the reserve was established at a level of $6.8 million and funded by a transfer from unspent income carried forward from previous years. It has since been maintained at that level.

A comprehensive risk and liability review has revealed that the UNDP-derived reserve formula does not adequately protect UNOPS against the risks to which it is exposed as a self-financing operational entity. The present report summarizes the findings and conclusions reached, and outlines an approach to risk management and reserve funding that is more closely correlated to its circumstances and risk exposure profile. The report and its recommendations have been reviewed and endorsed by the Management Coordination Committee.

The report recommends that the funding level of the UNOPS operational reserve be set at 4 per cent of the combined expenditures on administrative and project budgets of the previous year. Based on 1996 expenditures, the reserve level would be at $18.6 million. Drawdowns will be reported annually in the UNOPS financial report while the reserve level will be reviewed biennially in conjunction with the budget submission.

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I. BACKGROUND

1. Pursuant to Executive Board decision 94/32 of 10 October 1994, the United Nations Office for Project Services (UNOPS) became operational as a self-financing entity on 1 January 1995. In decision 95/1 of 10 January 1995, the Board approved the Financial Regulations of UNOPS and established the UNOPS operational reserve.

2. In its report DP/1994/62, UNOPS had proposed to review and quantify risks and liabilities to which it may be susceptible, in order to set appropriate reserve limits. Mindful of the observations of the Advisory Committee on Administrative and Budgetary Questions (ACABQ) contained in its reports in documents DP/1994/57 and DP/1995/13, the Executive Director, under the guidance of the UNOPS Management Coordination Committee (MCC), has undertaken that review.

3. The review drew from the following sources: reports of the United Nations Board of Auditors; the Office of Legal Affairs of the United Nations; the Insurance Section of the United Nations Office of Programme Planning, Budget and Accounts; private-sector firms, including insurance experts from the legal and securities areas; the former Treasurer and Deputy Director of Finance of the United Nations Development Programme; and the firm of Kamerbeek Assurantiemakelaars, which provides property insurance for the United Nations, and its associate, Arthur J. Gallagher and Company.

4. UNOPS has also drawn from its experience of two years in applying the business planning and financial management models it has developed. The present report summarizes the findings and conclusions UNOPS has reached, and makes recommendations with regard to the separate but related issues of risk management, reserve levels, and surplus income. The report has been reviewed and its recommendations endorsed by the MCC.

II. BASIC PREMISES

5. UNOPS is a fully self-financing entity with no assessed budget funding. At present, it manages more than 2,000 projects in 146 countries, with project budgets in excess of $1 billion. Inability on the part of UNOPS to meet administrative costs or to respond to the financial consequences of extraordinary or unanticipated contingencies could result in claimant demands that alternative financing arrangements be placed before the Executive Board, including that responsibility be shared with or assumed by UNDP, the United Nations, or other UNOPS clients. Consequently, UNOPS deems that it is obliged to identify and implement measures that will provide the maximum degree of financial protection for itself, the United Nations system, and its clients.

6. UNOPS has a short history as a separate entity. While it is recovering from the business downturn of 1993-1994, it is premature to conclude that two years of promising results establish a long-term trend. Nor can reliable inferences about the future of UNOPS be made from the different circumstances

that prevailed when it was part of UNDP. Furthermore, relevant historical data for comparable risks for United Nations entities, including UNOPS, are limited. In view of this uncertainty, UNOPS has made cautious and conservative assumptions with regard to the types and extent of risk exposure.

7. A key element in the UNOPS risk management approach is the use of alternative financing techniques and reserves. In order for these mechanisms to be effective, it is essential that they be fully funded and held in irrevocable and promptly available liquid assets, in similar fashion to that prescribed in UNDP Financial Regulation 12.2 (a).

III. RISK, RESERVES AND SURPLUS INCOME

A. UNOPS operational reserve

8. UNOPS Financial Regulation 8.3 specifies four elements to be covered by the operational reserve:

(i) Shortfalls in income;

(ii) Uneven cash flows;

(iii) Professional or contractual liabilities associated with UNOPS Services; and

(iv) Liabilities associated with UNOPS personnel contracts financed from the UNOPS Account.

9. Following UNDP practice, the initial level of the UNOPS operational reserve was set at 20 per cent of the annual administrative budget, rounded to the nearest hundred thousand dollars. Accordingly, the reserve was established in the amount of $6.8 million and funded by a transfer from unspent income carried forward from prior years. It has since been maintained at that level.

10. It was reasonable to use the parent organization's operational reserve as an initial model for that of UNOPS. UNOPS, however, has been established as a self-financing operational entity, with no normative role or funding activities. Experience and analysis have revealed a risk-exposure profile that is markedly different from that of UNDP, leading UNOPS to conclude that the UNDP-derived formula does not correspond to the actual type and extent of its risk exposure. Therefore, UNOPS has identified and quantified, to the extent possible, each element in its overall risk equation. These individual elements, presented in detail in the annex, have been used as the building blocks of an overall risk management and reserve approach that matches the actual risk exposure of UNOPS.

B. Risk and risk management mechanisms

Risk types

11. Risks have direct or indirect financial consequences which, if not anticipated and protected against, threaten the viability of the organization or the interests of its clients. Such risks originate from contingencies of various types:

(a) Professional, stemming from mistakes, oversights, or misdeeds of personnel;

(b) Contractual, stemming from agreements or contracts which the organization is bound to honour;

(c) Business, including diminished demand for services and projects which cannot be implemented as scheduled; and

(d) Force majeure, such as flood, storm, earthquake, civil instability, or war.

12. Overall risk exposure and contingent liability are greater now than they have traditionally been, owing to such factors as increasing competitiveness in development service markets; increasing technical complexity of projects, especially in the industrial and environmental sectors; and increasing litigation relating to contracts and to employment practices.

Financial implications of risk

13. Direct costs of the occurrence of risk contingencies include replacement of property, payment of claims or settlements, or honouring the terms of lease and service agreements.

14. Indirect costs of the occurrence of contingencies include legal costs; closure, suspension, or relocation of offices; restoration of electronic or manual records; payment and/or severance of surplus personnel; or unforeseen increases in operating costs.

15. UNOPS may incur significant cost in responding to risk occurrences even when it is not legally liable. For example, a bankrupt contracting firm that is unable to complete a project may technically be liable for the financial consequences of its failure to perform; however, if the firm's resources are not available, or would be available only after long and expensive litigation, the interests of the project and/or the UNOPS client would suffer. The same would be true in the case of an individual consultant's errors, omissions, or failure to perform, when enforcement and recovery options may be even fewer. While UNOPS does and will continue to utilize diligently the legal and institutional protections available to it, circumstances could arise under which UNOPS may choose to assume responsibility or to share responsibility with its partners. In other cases, the expeditious resolution of a dispute or claim may prove less costly than the anticipated direct and indirect cost of litigation even if a favourable judgement may be expected. The reserve functions as a bridging

mechanism that covers costs pending the outcome of litigation, as a source of funds with which to respond to unsuccessful litigation, or as an alternative to litigation which could be successful but unenforceable.

Risk management mechanisms

16. UNOPS employs several types of financial and non-financial mechanisms to limit risk or its effects, with the operational reserve as the safety net and final recourse behind them all:

(a) Limitation of risk. The United Nations Convention on Privileges and Immunities extends jurisdictional immunity and reduces the risk of frivolous litigation or doubtful claims. Protection is also provided through the terms of the UNDP Standard Basic Assistance Agreements (SBAAs), which apply to the majority of projects for which UNOPS provides services. In addition, training and education of staff can help reduce the incidence of mistakes - an example of this is the contract training programme, a comprehensive and practical course on the essentials of contract formation and administration, developed by UNOPS with an outside training institution and attended by over 100 UNOPS staff;

(b) Management of risk. Certain types of risk can be anticipated and protected against by careful management. To the extent that this happens, it enables risk protection to be included in routine management and budgetary practices and reduces the likelihood of surprises for which preparation is inadequate. Examples of this type of mechanism are the Financial Management Model, presented previously in document DP/1995/60 and used to synchronize administrative expenditures with delivery and income, and the annual UNOPS Business Plan;

(c) Transfer of risk. Some risks can be transferred to other parties. The primary mechanisms for doing this are the purchase of insurance policies and the assignment of responsibility and liability through written agreements and contracts. Of these two, the former is more secure although more costly and may not always be available. The degree of protection provided through agreements and contracts can vary widely: Governments, organizations, agencies, firms and individuals may assume responsibilities that they subsequently prove unable or unwilling to honour, or for which enforcement actions could prove expensive, time-consuming, or even impossible;

(d) Assumption of risk. Risk exposures not addressed fully through any of the preceding mechanisms have to be assumed. Although the mechanism for doing this is known both as "self-insurance" and as "reserves", the two are the same: an amount of liquid assets derived from UNOPS income that is set aside, outside the normal administrative budget, with the expectation that it will not be drawn from unless the contingencies that warranted its establishment have occurred. Reserves are of paramount importance in risk management as they are always the last recourse within the UNOPS span of control. In the event that these resources proved insufficient to satisfy claims or liabilities, it must be anticipated that claimants might attempt to shift their claims to UNDP, the United Nations, or to other UNOPS clients.

C. Summary and reserve levels

17. The table summarizes the basic elements on which the proposed operational reserve is based. The annex explains in detail the nature of each area of risk exposure and the rationale behind the proposed management response. Data from fiscal year 1996 have been used in the table for calculating an end-of-year indicative total reserve requirement.

18. Recommendation. The sum of the various reserve elements, based on 1996 figures, is $17.45 million. This amount is equal to slightly less than 4 per cent of the combined 1996 administrative and project expenditure of $465.2 million. In order to facilitate administration of the reserve, UNOPS recommends that the level of the operational reserve be set at 4 per cent of the combined expenditure on administrative and project budgets of the previous year.

19. While the annex provides an item-by-item explanation of the basis for this recommendation, there are two general points that should also be borne in mind:

(a) The combined administrative and project expenditures of UNOPS for 1997 are projected to be in excess of $500 million. A reserve capitalized at 4 per cent of the total value of funds disbursed by UNOPS in a given year is a conservative level for an organization of the UNOPS type, inasmuch as consultants advise that comparable not-for-profit organizations maintain reserves of 5-10 per cent of annual expected cash flow;

(b) Initial financial uncertainty has resulted in the slowdown or deferral of some administrative expenditures, especially in the areas of staff and information systems. With two years of improving performance, needed expenditures are being cautiously resumed. However, a short-term result of fiscal restraint has been to increase the balance of unspent income. This unspent income affords a narrow window of opportunity for reserve funding that could disappear as administrative costs return to normal levels and/or UNOPS business declines.

UNOPS risk exposure: Summary

I. OVERVIEW OF RECOMMENDED COMPONENTS OF UNOPS OPERATIONAL RESERVE		
Type of risk	Calculation basis	Amount ($)
I. SHORTFALLS OF INCOME AND UNEVEN CASH FLOWS		
Downturn of new business Variability in portfolio Fluctuations in income rates	15% of annual administrative budget	4 900 000
II. PROFESSIONAL OR CONTRACTUAL LIABILITIES ASSOCIATED WITH UNOPS SERVICES		
General professional and contractual liabilities	1.5% of project delivery of previous year	6 500 000
Property	Contingency provision	200 000
Information systems	Contingency provision	250 000
Business interruption	Contingency provision	500 000
Torts/third-party liability	Contingency provision	1 000 000
III. LIABILITIES ASSOCIATED WITH UNOPS PERSONNEL CONTRACTS FINANCED FROM THE UNOPS ACCOUNT		
Downsizing	Contingency provision	3 000 000
Appendix D liabilities	1% of staff/common cost of previous year	200 000
Employment practices	Contingency provision	1 000 000
INDICATIVE TOTAL (for end-of-year 1995)		17 550 000
RESERVE RATIO	1996 expenditure Administrative 32 200 000 Project 433 000 000 TOTAL 465 200 000 Reserve ratio: $17.55 million/$465.2 million = 3.77% Rounded to: 4% or, $18.6 million	

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D. Reserve funding, drawdowns, and reporting

20. Accordingly, it is proposed that available unspent income be used to bring the reserve up to a fully funded level. At the end of 1996, UNOPS had a balance of $10.8 million in accumulated unspent income. Transfer of this unspent income to the current reserve of $6.8 million will bring the reserve balance to approximately $17.6 million. UNOPS will use the unspent income of subsequent years to achieve full funding of the proposed reserve level. Barring any major drawdowns from the reserve, UNOPS expects to reach full funding of the reserve by the end of the current biennium.

21. UNOPS Financial Regulation 8.3 requires that drawdowns from the operational reserve be reported by the Executive Director to the Executive Board. This will be done annually as part of the UNOPS regular financial reporting. This will, in conjunction with ongoing operational oversight provided by the MCC, provide a framework for ensuring that the reserve is properly used and managed.

22. The level of the reserve is a function of overall business volume, administrative cost, and risk exposure. The Executive Director will, taking these factors into account, report on the reserve every second year upon submission of the biennial budget proposal, and will make such recommendations regarding the reserve as are appropriate.

E. Surplus income

23. Surplus income is that amount of income which, at year end, is over and above that required to cover expenditures incurred under the year's administrative budget, and to fund or replenish operational reserves.

24. Conscious of the fact that its income is derived from resources whose principal purpose is to assist nations and people in need, UNOPS makes every effort to meet or exceed the performance expectations of its clients in as cost-effective a manner as possible. This is a key element of the value that UNOPS strives to add when providing its services. The unique managerial challenge of UNOPS is to maintain a balance between incurring a deficit, on the one hand, and accumulating a surplus in excess of its needs, on the other. Although either is possible, a deficit is the greater danger.

25. UNOPS has developed, and continues to improve, various tools that help it match its income with its basic financial needs. These include the above-cited Financial Management Model and the Business Plan, as well as improved budgeting and reporting procedures and regular negotiations with clients on fee structures. UNOPS notes that its costs are presently well below those of other United Nations agencies and those of commercial entities, and is committed to maintaining this position.

26. The planning, analysis, and reporting tools UNOPS has developed since 1994 establish a transparent framework that facilitates monitoring of all dimensions of UNOPS performance, including shortfalls or surplus of income. These measures will enable UNOPS, the MCC, and the Executive Board to identify and address any emerging issues with regard to the UNOPS financial position.

F. Follow-up

27. The measures presented herein are expected to provide at the present time an appropriate level of protection for UNOPS, for its clients, and for the United Nations system. One of the key lessons learned from this analysis, however, is that risk exposure is not static: assessing and managing risk are ongoing management responsibilities. Two immediate actions UNOPS will take in this regard are:

(a) The Directorate will in future maintain and oversee documents and information relating to UNOPS risk exposure in conjunction with the annual business planning process. Such information was previously unavailable or dispersed throughout the organization;

(b) Discussions are under way, at the time of writing the present report, with the United Nations and with other agencies to resolve pending insurance coverage questions. UNOPS will provide updated information at the third regular session although it is not expected that the recommendations contained in the present report will change on the basis of these discussions.

IV. DRAFT DECISION

28. The Executive Board may wish to:

(a) Take note of the report of the Executive Director of the United Nations Office for Project Services (DP/1997/26);

(b) Decide to establish the level of the UNOPS operational reserve at 4 per cent of the combined expenditure on administrative and project budgets of the previous year, and to transfer unspent income to the reserve account until such level is reached;

(c) Approve the maintenance of the operational reserve at the level calculated annually according to the formula in the preceding paragraph;

(d) Request that the Executive Director report on a biennial basis on the appropriateness of the level as set in the present decision;

(e) Note that the Executive Director will continue to report annually on UNOPS income and expenditure levels and on drawdowns from the reserve.

Annex

RISK MANAGEMENT, RESERVES AND SURPLUS INCOME

1. The basis used by UNOPS for analysing each operational reserve category is explained below. A summary of all categories is presented in the table in the main report.

2. It should be noted that UNOPS has a single operational reserve with which to respond to contingencies of many types. None of the amounts for the individual categories specified below are sufficient to respond to a worst-case scenario occurring in that category, nor are they ceilings limiting drawdowns against that type of contingency. Had a full-funding approach for each contingency been taken, the total amount of the reserve would have been much larger than that proposed. Instead, UNOPS has assumed that not all contingencies will occur at the same time. Therefore, a drawdown in excess of the amount used for any category in this calculation would be buffered by other resources in the reserve. It is intended that the amount of such drawdowns will be recouped through the annual reserve replenishment process.

3. When possible, UNOPS has arrived at category amounts by using or drawing from precedents elsewhere in the United Nations system or in similar non-United Nations organizations. When this has not been possible, UNOPS has estimated the cost of various scenarios and then specified a contingency provision as a reasonable basis for response. Given the many uncertainties regarding the magnitude and probability of each risk contingency occurrence, these amounts are estimates based on both analysis and on management judgement.

I. SHORTFALLS OF INCOME AND UNEVEN CASH FLOWS

Income shortfalls

4. Financial Regulation 8.3 identifies shortfalls of income and uneven cash flows as separate categories for which reserves may be used: in practice there is little difference for UNOPS between the two concepts other than their duration. Both have the same effect of reducing income below the cost of operation.

5. UNOPS is highly vulnerable to contingencies in this category: the events that cause income shortfalls are generally beyond the short-term control of UNOPS, and corrective measures may not yield immediate results.

6. UNOPS makes various types of forward commitments within its approved or revised budget, e.g., hiring of personnel, leases, and service agreements. The ability of UNOPS to meet these commitments is dependent upon the generation of income, which itself depends on delivery of services. Any major disruption in delivery could result in a drop in income, leaving UNOPS unable to meet its financial commitments. Such disruptions can stem from:

(a) Downturn in new business. A downturn of business with a major client has a direct negative impact on UNOPS delivery and income. Such downturns could result from a client choosing another alternative for project services, from disruptions in the client's own funding base, or from other causes. If this downturn is prolonged, and not substituted with business from another client, it is likely to result in a downsizing of UNOPS. The likelihood of this situation seems distant; however, if such a trend were to develop, it might by that time be too late to build a financial safety net with which to weather a downsizing effort;

(b) Variability in overall portfolio. UNOPS is a demand-driven organization: there is considerable variation from year to year in the overall composition of its portfolio, with different types of services producing different income rates. UNOPS has no control over this variability, and must be in a position to buffer itself from the effects of it;

(c) Fluctuations in income rates. Income rates are also prone to change from time to time, so even when delivery volume is stable, the amount of income derived therefrom is not completely predictable. This is a special concern with the introduction by UNDP of a new rate structure for administrative and operational services, the impact of which is at this time uncertain.

7. With some exceptions, these types of contingency do not occur without warning. Therefore, the primary risk management mechanisms used to limit their impact are the Financial Management Model and the Business Plan. Nonetheless, planning and monitoring are not exact sciences: while the portfolio value and project and administrative expenditures are monitored on a monthly basis, actual income for the year is not conclusively known until the fiscal year accounts are closed, three months into the following year. Thus, while some corrective action can be made within the year, meaningful budgetary adjustments will generally occur after the events that triggered them. It is therefore possible for expenditures to be incurred prior to receipt of income that will cover them.

8. Conclusion. While the management mechanisms UNOPS has put in place afford considerable protection against these types of contingency, it would be improvident to provide no margin for unanticipated shortfall of income. UNOPS estimates that inclusion in the operational reserve of a contingency provision equal to 15 per cent of the annual administrative budget will provide a reasonable level of protection. This figure is derived from setting aside two months of the annual administrative budget, or 16.7 per cent, rounded down to 15 per cent.

II. PROFESSIONAL OR CONTRACTUAL LIABILITIES ASSOCIATED WITH UNOPS SERVICES

9. The nature of UNOPS work involves it annually in thousands of professional and contractual relationships with donors, Governments, firms, non-governmental organizations, United Nations agencies, and individuals. The dollar value of these relationships is near $500 million annually. All parties consulted in the risk review, including the Office of Legal Affairs and the firm of Kamerbeek/

Gallagher, agree that risk exposure in this category is extensive, complex, and difficult to predict or quantify.

10. Some contingencies in this category are specific, and can be targeted with equally specific management mechanisms. A larger group is of a more general nature. Strategies for responding to both groups are outlined below.

General professional and contractual liabilities

11. UNOPS manages, executes and implements development projects of every conceivable type. Some are relatively simple and straightforward, such as purchasing off-the-shelf equipment and supplies. Others are complex and potentially risky, such as procuring and overseeing installation of the custom-built equipment for Montreal Protocol projects or conducting demining activities. Having reviewed UNOPS contracting procedures and experience in project implementation, OLA has identified a number of potential liabilities that might arise in this connection. While noting that in many cases UNOPS can protect itself through contractual clauses and insurance policies, OLA points out that cases do arise where an obligation to pay damages may not be totally excluded or where losses incurred may not be recoverable. OLA also cites cases of claims that may have to be resolved by formal arbitration proceedings that may rule against UNOPS, or would involve substantial expense even if the defense of the claim were successful.

12. The mechanisms for managing these risks are numerous: the United Nations Convention on Privileges and Immunities and the SBAA extend jurisdictional immunity and reduce the risk of frivolous litigation or doubtful claims. UNOPS has itself invested in training its staff to avoid pitfalls in the contracting area. Managerially, through its reorganization process, UNOPS has strengthened internal control capacity by establishing the function in the new Finance, Control and Administration Division. It also operates two important committees, the Project Acceptance Committee, which screens new and revised projects, and the Procurement Review and Advisory Committee, which reviews all major contracting and procurement activity. The Rosters Unit is now obtaining financial background information on major firms. UNOPS also transfers risk, when possible, through extensive insurance coverage and through the inclusion of protective clauses in contract and agreement documents. The latter are maintained and overseen by the newly established Policy and Contracts Division.

13. Notwithstanding these precautionary measures, UNOPS is still exposed to residual risk in this area. Kamerbeek/Gallagher have advised that while there appear to have been no serious claims to date, it should be assumed that the loss would be substantial if claims were to occur. The risk review highlighted errors and omissions of staff as one potential source of such risks. This is a potentially insurable risk, but Kamerbeek/Gallagher have pointed out that this cannot be accomplished without a benchmarking of claims history and current exposure. UNOPS has begun this type of benchmark documentation although it is anticipated that the ultimate approach will involve a mix of commercial insurance and self-insurance.

14. Conclusion. To complement and backstop the other measures UNOPS is taking in regard to this risk area, a contingency provision equal to 1.5 per cent of

the total project expenditure of the previous year should be included in the operational reserve. This percentage has been reviewed with Kamerbeek/Gallagher, who have judged this to be a reasonable starting point for reserve funding.

Specific professional and contractual liabilities

15. Specific liabilities for which UNOPS has taken and/or recommends action are described below.

Shipping

16. UNOPS ships and transports goods of all types, using well-documented and closely monitored procedures that adhere to the international standards established by the International Chamber of Commerce (INCOTERMS). UNOPS shipments are normally insured through a global open-cargo policy, obtained at an annual premium of approximately $600,000.

17. Conclusion. The risk review has concluded that documentation and monitoring procedures can be further improved but that the insurance coverage is appropriate to UNOPS needs. No further action is necessary at this time.

Property

18. Kamerbeek/Gallagher have estimated the value of UNOPS property at New York headquarters at $6 million. This estimate does not take into consideration property at other locations. (This property is office equipment, furniture, etc. UNOPS does not own any of its office premises or other real estate.) The risk review revealed that UNOPS premises are not included in general United Nations property insurance coverage.

19. Conclusion. UNOPS is proceeding to obtain replacement-value insurance coverage for all property owned by it, preferably in conjunction with the United Nations. The cost of this coverage will be included in the next revised budget. In addition, inclusion in the operational reserve of a contingency provision of $200,000 will provide self-insurance sufficient to cover deductibles and/or replacement of items not covered by property insurance.

Information systems

20. UNOPS is heavily dependent upon its information systems technology. The risk review noted that UNOPS does not have an explicit disaster recovery plan, nor are there funds with which to arrange for data recovery or restoration, alternate site operations, or the many other costs associated with a system which fails or is damaged.

21. Conclusion. UNOPS will develop a disaster recovery plan; in addition, inclusion in the operational reserve of a contingency provision estimated at $250,000 will allow for an initial response to an information systems crisis.

Business interruption

22. Kamerbeek/Gallagher have noted that UNOPS has no protection for the costs, direct and indirect, of a business interruption. Such an interruption could be the result of a natural cause (flood, fire), civil unrest, or terrorist action.

23. Conclusion. While business interruption may prove to be an insurable risk, inclusion in the operational reserve of a contingency amount estimated at $500,000 will provide either interim or longer-term protection against this risk.

Torts and third-party liabilities (for non-vehicular injuries and losses)

24. Kamerbeek/Gallagher have found that UNOPS is not covered under the United Nations self-insurance reserve with regard to injury or property damage losses to third parties. The United Nations reserve is funded from annual appropriations by the General Assembly and augmented with interest earned from the reserve amount, currently $2.2 million. Since the United Nations reserve is in any case applicable only to the Headquarters district of New York, UNOPS participation in this scheme would not provide coverage for office locations outside New York. UNOPS headquarters and other lease agreements require it to be "self-insured" although there are no provisions made for this. As with the employment practices liabilities mentioned below, legal defense costs are often the largest part of the expenses for claims of this type.

25. Conclusion. UNOPS is exploring participation in the United Nations self-insurance scheme and/or other insurance alternatives. In the meantime, inclusion in the operational reserve of a contingency provision of $1 million will provide self-insurance with regard to third-party and tort claims.

III. LIABILITIES ASSOCIATED WITH UNOPS PERSONNEL CONTRACTS FINANCED FROM THE UNOPS ACCOUNT

26. In recent years, protection for all categories of personnel has improved, largely through the application of appendix D of the United Nations Staff Regulations and Rules and through associated insurance policies. There is, however, sizeable exposure with regard to staff on the administrative budget, as explained below.

Downsizing

27. Salaries and common staff costs in 1996 totalled $19.7 million, or 61 per cent of the total administrative costs. The approved staffing table provides 244 posts: 91 Professional and 153 General Service. A total of 133 staff members hold UNDP Letters of Appointment and have permanent contracts. A sustained downturn of business, or shortfall of income, would require that UNOPS begin laying off staff, with attendant costs.

28. The principal mechanisms for limiting risk in this regard are managerial. First, UNOPS relies increasingly on the use of non-permanent contracts, as is appropriate for a self-financing organization. Second, the Financial Management

Model and the Business Plan provide a framework within which management can anticipate, and either prevent or prepare for, imminent changes.

29. If staff reductions were necessary, the first steps would involve non-renewal of some fixed-term contracts and a request to UNDP (or other originating agencies) to accelerate absorption of their contract holders back into their own staffing tables. The cost to UNOPS of staff reduction could vary significantly according to some of the following factors:

(a) The pace at which UNDP and other originating agencies can re-absorb staff assigned to UNOPS;

(b) The proportion of any severance benefits payable to UNDP staff that would be borne by UNOPS;

(c) The rapidity with which reductions would need to be accomplished and the length of time for which UNOPS may be obliged to carry excess staff as an alternative to severance;

(d) The amount of time remaining on fixed-term contracts of various types, and whether foreshortening of such contracts is operationally possible; and

(e) The value of termination indemnities that may become payable to non-UNDP staff with significant length of tenure with UNOPS.

30. Conclusion. The operational reserve should include a provision of $3 million for the downsizing contingency. This figure is based on the assumption of payment of salary and/or indemnity for no more than 15 per cent of administrative budget staff in one year.

Appendix D liabilities

31. Appendix D of the United Nations Staff Regulations and Rules defines the entitlements for death, disability and reasonable costs and damages payments. While insurance coverage of various types provides the means for payment of these entitlements for eligible staff in the field, the risk review has revealed that there is no provision for honouring such claims for personnel employed under the administrative budget. Once again, the protection against this contingency is supposed to be provided by a "self-insurance" fund although one does not as such exist. UNOPS is not a participant in the United Nations special reserve for this purpose.

32. Conclusion. The operational reserve should include a contingency provision equal to 1 per cent of the staff and common costs of the previous year for meeting claims relating to appendix D. This percentage is derived from that used successfully by the United Nations for its appendix D reserve. In view of the different size and composition of the risk pool, UNOPS will closely monitor appendix D claims to ensure that this percentage is appropriate for UNOPS.

Employment practices

33. Kamerbeek/Gallagher have drawn the attention of UNOPS to the question of employment practices liability, with special mention being made of issues such as hiring practices, equal opportunity, discrimination, sexual harassment and job-performance reviews. The extent to which United Nations entities are susceptible to these claims is ambiguous although there are recent examples of such claims having been pursued with financial repercussions to the organization. Kamerbeek/Gallagher point out that defence costs are often the largest part of the expenses for claims of this type.

34. Conclusion. UNOPS will, following the recommendation of Kamerbeek/Gallagher, obtain further clarification regarding the extent of this type of exposure and the possible cost of insurance. Inclusion in the operational reserve of a contingency provision estimated at $1 million provides protection for claims against employment practices.